

Principles of
**FINANCIAL
ACCOUNTING 3e**

IFRS Edition

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Setting the Stage



*The government officers and lawmakers in Taiwan are required to periodically disclose to the public their financial position such as cash holding, property, stock investments, and liabilities. This regulation is called the **sunlight bill**.*

Such a disclosure requirement is to increase the transparency of the financial status of these individuals so that any unusual change in their wealth can be detected.

Financial Statements: An Overview

LO1

The Balance Sheet

LO2

The Statement of Comprehensive Income

LO3

The Statement of Changes in Equity

LO4

The Statement of Cash Flows

LO5

Notes to the Financial Statements

LO6

The External Audit

LO7

Fundamental Concepts and Assumptions

Primary Financial Statements

According to IAS 1, a complete set of financial statements includes

Balance Sheet (Statement of Financial Position) 資產負債表

Statement of Comprehensive Income 綜合損益表

Statement of Changes in Equity 權益變動表

Statement of Cash Flows 現金流量表

Components of a Balance Sheet 資產負債表

LO1

Assets 資產

- A resource controlled by the entity as a result of past events.
- Future economic benefits are expected to flow to the entity.

Common Assets		
Asset	Definition	Example
Cash	Coins, currency, checks.	The amount in a company's checking account.
Accounts Receivable	An economic resource arising from providing goods or services to a customer on account.	The company providing a consulting service to a client on account will give rise to the company accounts receivable from the client.
Inventory	Items that are purchased or manufactured by a company and are resold.	The items you see on the shelves in Carrefour are considered by Carrefour as inventory.
Buildings	Structures used in the operations of a business.	The physical store itself is classified by Carrefour as a building.

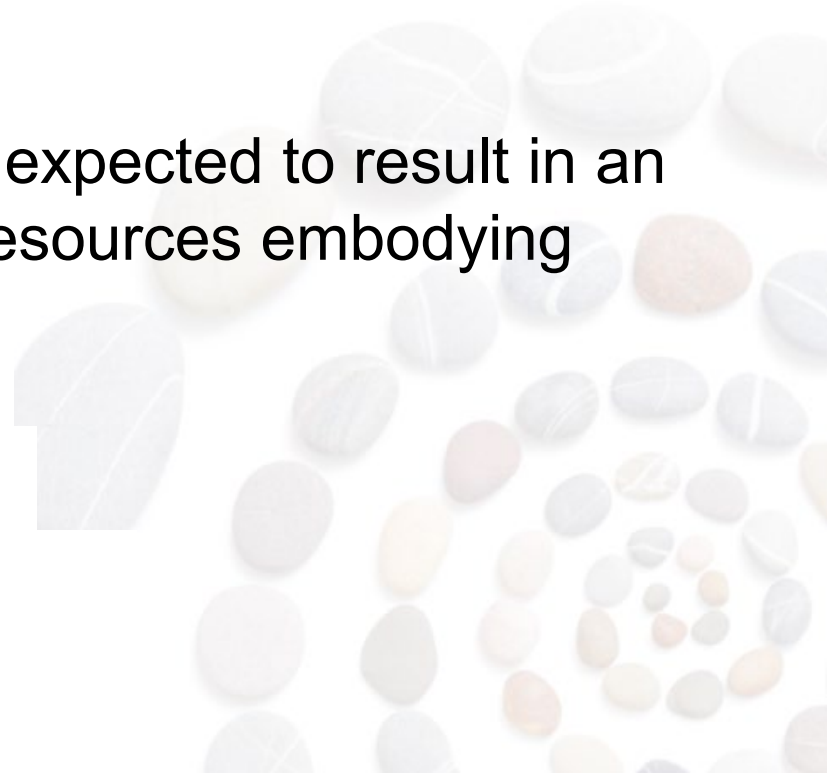
Exhibit 2.1 Common Assets

Components of a Balance Sheet 資產負債表

LO1

Liabilities 負債

- A present obligation of the entity arising from past events.
- The settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.



Components of a Balance Sheet 資產負債表

LO1

Liabilities 負債

Common Liabilities		
Liability	Definition	Example
Accounts Payable	Amount owed as a result of the purchase of goods and services on credit.	The amount owed by a company for inventory that was purchased on credit and has not been paid for yet.
Income Taxes Payable	Amount owed to governments resulting from the application of tax laws.	Corporate income tax owed but not yet paid.
Mortgage Payable	Amount owed relating to the purchase of property.	The loan associated with the purchase of a home or building.
Unearned Revenue	Amount owed in services or product (not money) to a customer who paid in advance.	A publisher owes a customer who bought a 12-month magazine subscription.

Exhibit 2.2 Common Liabilities

Components of a Balance Sheet 資產負債表

LO1

Equity 權益

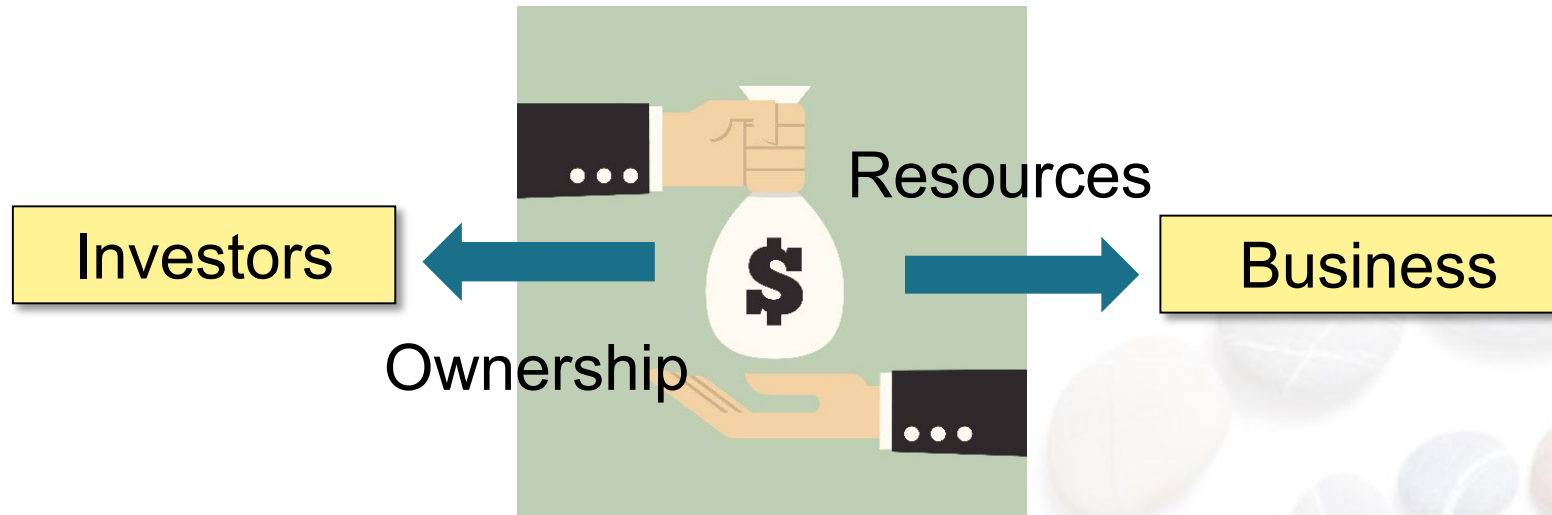
- The residual interest in the assets of the entity after deducting all its liabilities.
- It represents the **net assets** (Total Assets – Total Liabilities) available after all obligations have been satisfied.

Exhibit 2.3 Sources of Equity

Sources of Equity		
Equity	Definition	Example
Capital Stock	The amount given by shareholders to obtain shares of stock from a company.	A company sells shares of stock to the public. The amount the company receives is Capital Stock.
Retained Earnings	Earnings that are retained in the business.	If a company reports net income for the year of \$100,000 and reinvests the entire amount in the business (doesn't distribute dividends to its owners), the Retained Earnings is \$100,000.

Ownership of a Company

LO1

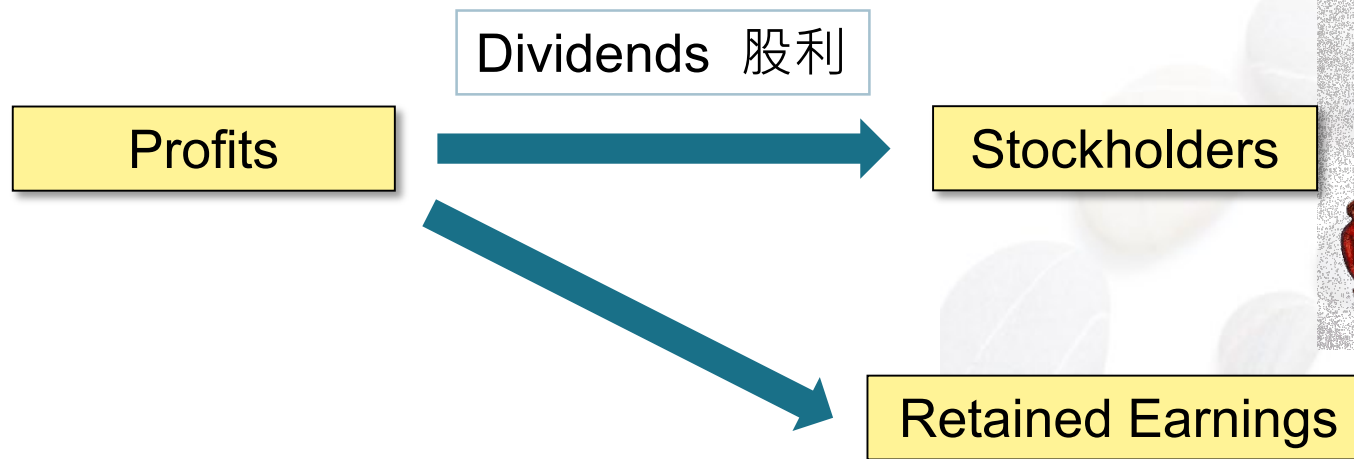


- ◆ a sole proprietorship
- ◆ a partnership
- ◆ a corporation: stockholders (shareholders)

Ownership of a Company

LO1

- The portion of equity contributed by owners in exchange for shares of stock is called **capital stock 股本**.



Retained Earnings 保留盈餘：

The amount of accumulated earnings of the business that have not been distributed to owners.

Changes of Equity

LO1

Equity **increases** when

- Owners make additional investments in a business.
- The business generates profits.

Equity **decreases** when

- Owners take back part of their investment.
- Operations generate a loss.
- Dividends are distributed to stockholders.

Accounting Equation

LO1

The accounting equation gives you a glimpse of **double entry accounting**.

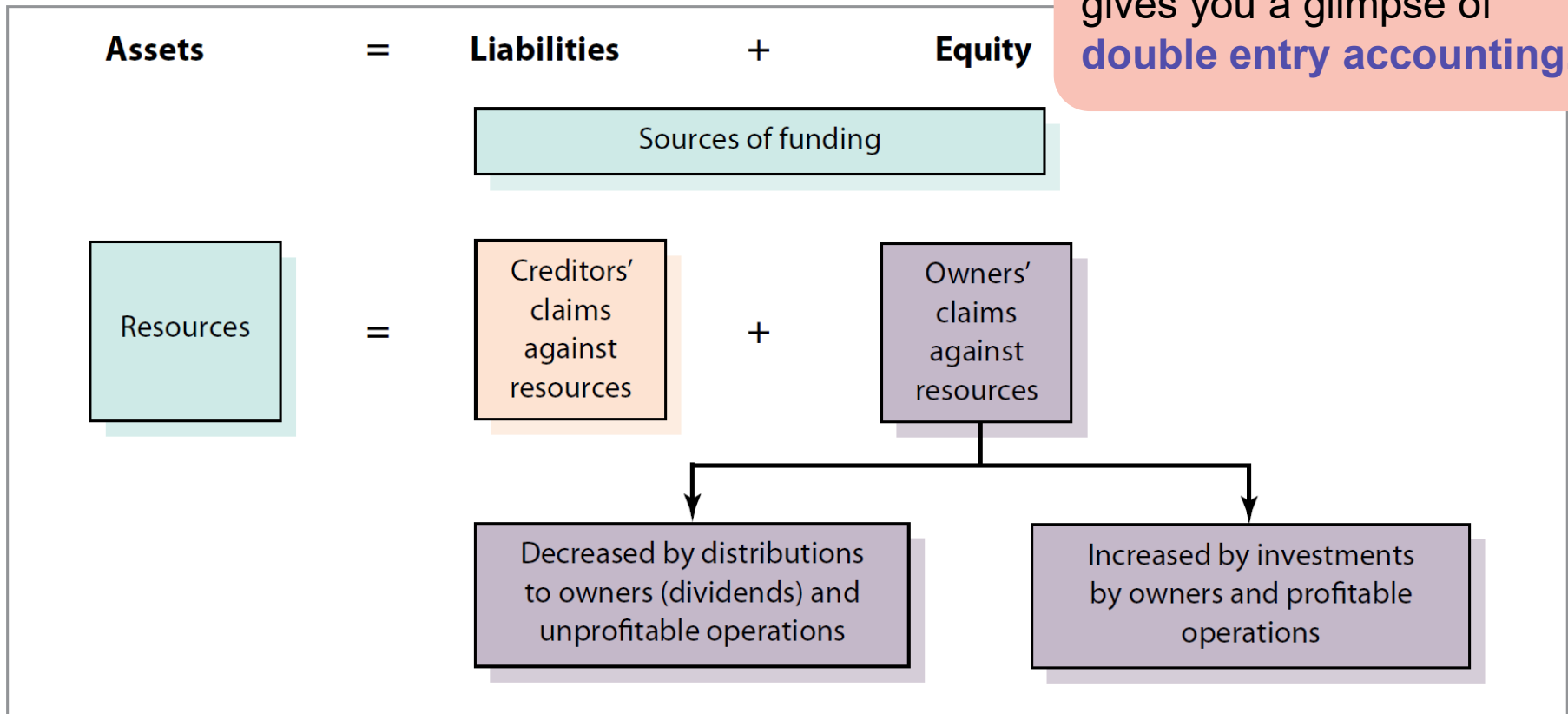


Exhibit 2.4 Elements of the Accounting Equation

The Format of a Balance Sheet

LO1

High Speed Company Balance Sheet December 31, 2022 and 2021 (Amounts in Thousands of New Taiwan Dollars)

a particular date

High

2022

2021

Assets

Current assets:

Cash and equivalents	\$2,411	\$2,472
Receivables	317	138
Supplies	830	841
Prepaid expenses and other current assets	260	791
Total current assets	<u>\$3,818</u>	<u>\$4,242</u>

Non-current assets:

Property, plant, and equipment:

Land	\$ 500	\$ 422
Plant and equipment	5,837	5,652
Less: Accumulated depreciation	(915)	(604)
Total property, plant, and equipment, net	<u>\$5,422</u>	<u>\$5,470</u>
Total assets	<u><u>\$9,240</u></u>	<u><u>\$9,712</u></u>

Low

liquidity → **Classified Balance Sheet**

Exhibit 2.5

The Format of a Balance Sheet

LO1

		Liabilities and Equity	
<div>High</div> <div>↓</div> <div>Low</div> <div>liquidity</div>	Current liabilities:		
	Short-term loans	\$ 715	\$ 927
	Accounts payable	490	530
	Salary payable	535	148
	Income tax payable	636	656
	Other accrued liabilities	315	849
	Total current liabilities	<u>\$2,691</u>	<u>\$3,110</u>
	Non-current liabilities:		
	Bonds payable	\$1,000	\$1,000
	Long-term bank loans	1,359	1,587
	Other liabilities	699	671
	Total non-current liabilities	<u>\$3,058</u>	<u>\$3,258</u>
	Total liabilities	<u>\$5,749</u>	<u>\$6,368</u>
Equity:			
Capital stock		\$2,100	\$2,100
Retained earnings		611	464
Other equity		780	780
Total equity		<u>\$3,491</u>	<u>\$3,344</u>
Total liabilities and equity		<u>\$9,240</u>	<u>\$9,712</u>

Exhibit 2.5

The Format of a Balance Sheet

LO1

INTERNATIONAL

- IAS 1(provision 57) does not require the order or format in which a company presents the balance sheet items.
- Philips' balance sheet

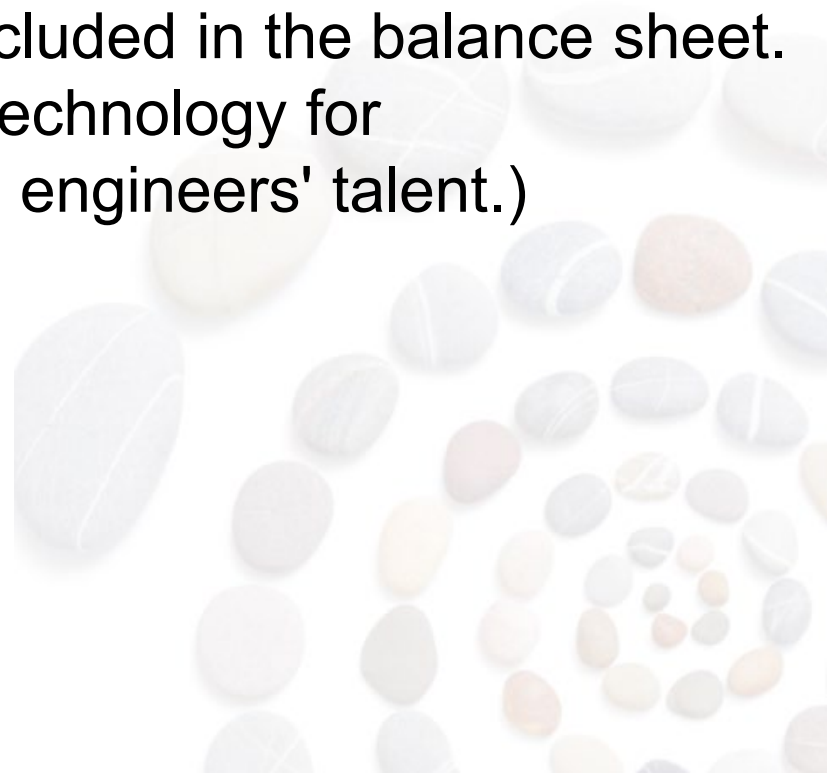
Philips Group
Consolidated balance sheets in millions of EUR unless otherwise stated
 As of December 31

		liquidity
Non-current assets		Low
2 10	Property, plant and equipment ¹⁾	
2 11	Goodwill	
2 12	Intangible assets excluding goodwill	
16	Non-current receivables	
5	Investments in associates	
13	Other non-current financial assets	
28	Non-current derivative financial assets	
8	Deferred tax assets	
14	Other non-current assets	
Total non-current assets		
Current assets		High
15	Inventories	

Limitations of a Balance Sheet

LO1

- Accountants record many assets at their purchase cost, not at their current **market value**. (e.g., land)
- Not all economic assets are included in the balance sheet. (e.g., **TSMC's reputation**, its technology for semiconductor foundry, and its engineers' talent.)



LO1

The top illustration shows three grey oil barrels with the word 'OIL' written on them. A black hose is connected to a green fuel nozzle. The bottom illustration shows a white pill bottle with a red 'Rx' label and three green pills in front of it.

Quiz Yourself

LO1

- **Review Philips' balance sheet in Appendix B and answer the following questions:**

1. What is the amount of Philips' total reported assets?

Philips' total reported assets on December 31, 2019, were €27,016 million.

2. What is the amount of Philips' total reported liabilities?

Philips' total reported liabilities on December 31, 2019, were €14,391 (€6,978 + €7,413) million.

Quiz Yourself

LO1

3. Are Philips' assets financed more through liabilities or through equity?

Philips' assets are financed primarily using liabilities.

4. What is Philips' largest reported asset?

Philips' largest reported asset category was Goodwill.

5. What is Philips' largest reported current liability and what does that amount represent?

Philips' largest current liability is Accounts Payable with a balance of €2,089 million.

Components of a Statement of Comprehensive Income 綜合損益表

LO2

Revenues 收益

- The amount of assets created through the sale of goods and services.

Expenses 費損

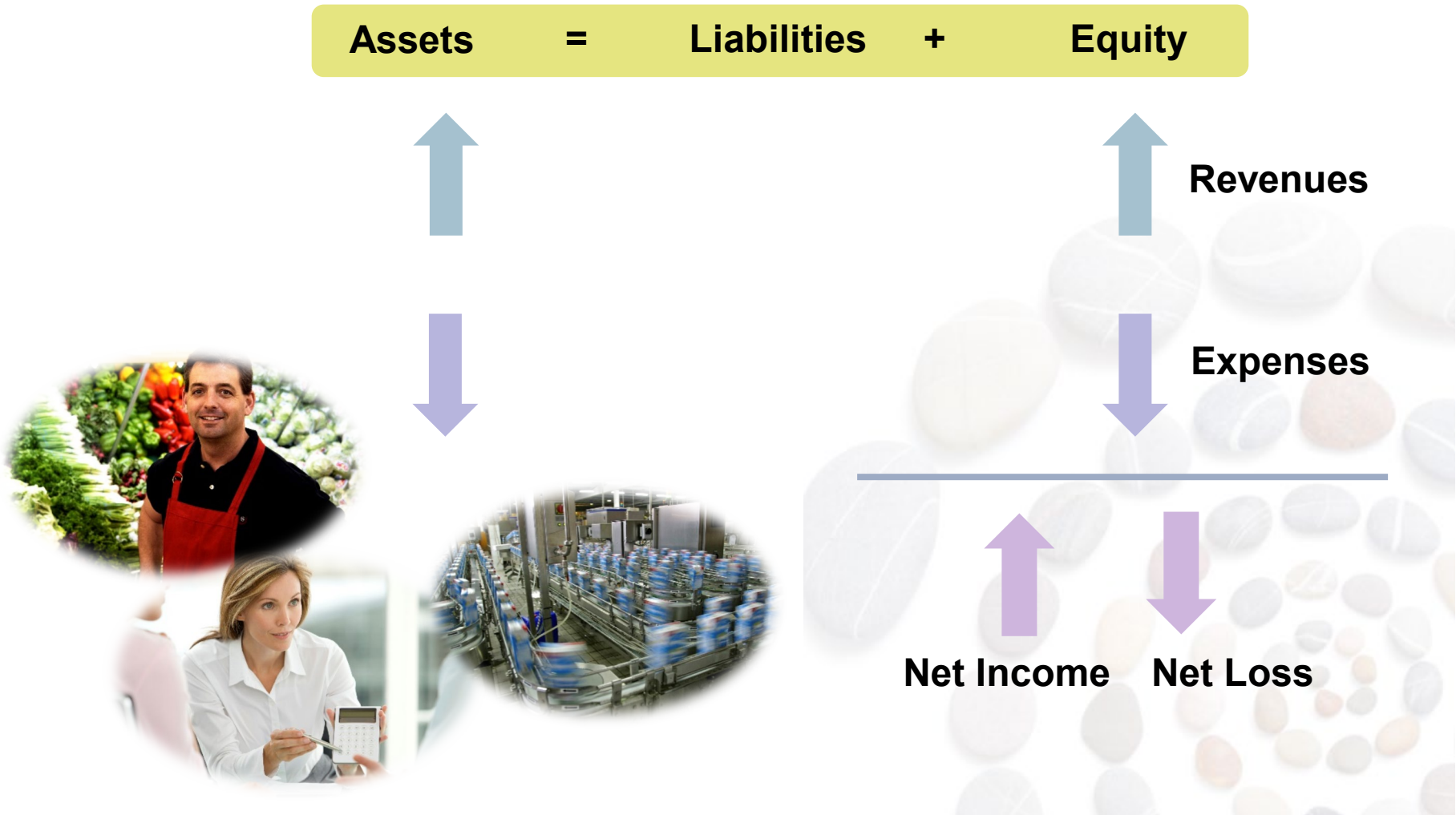
- The costs incurred in normal business operations to generate revenues.

Net Income 淨利 (or Net Loss 淨損)

- An overall measure of the performance of a company.
- **Net Income = Revenues – Expenses**

Components of a Statement of Comprehensive Income 綜合損益表

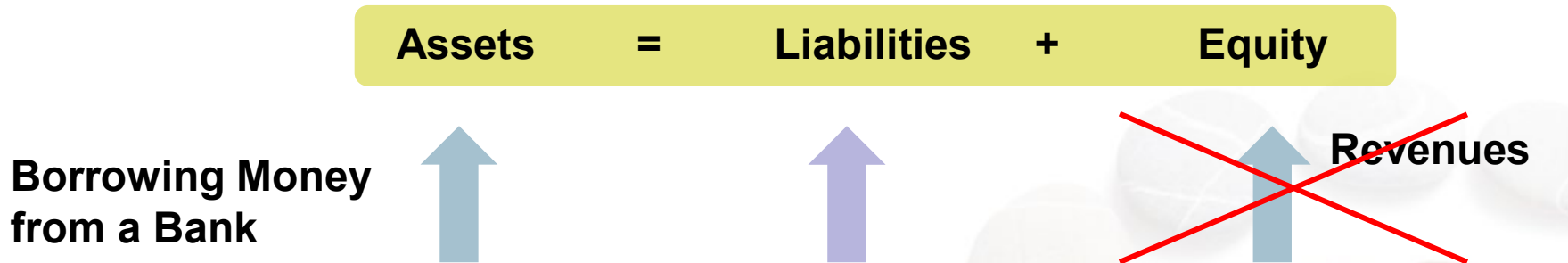
LO2



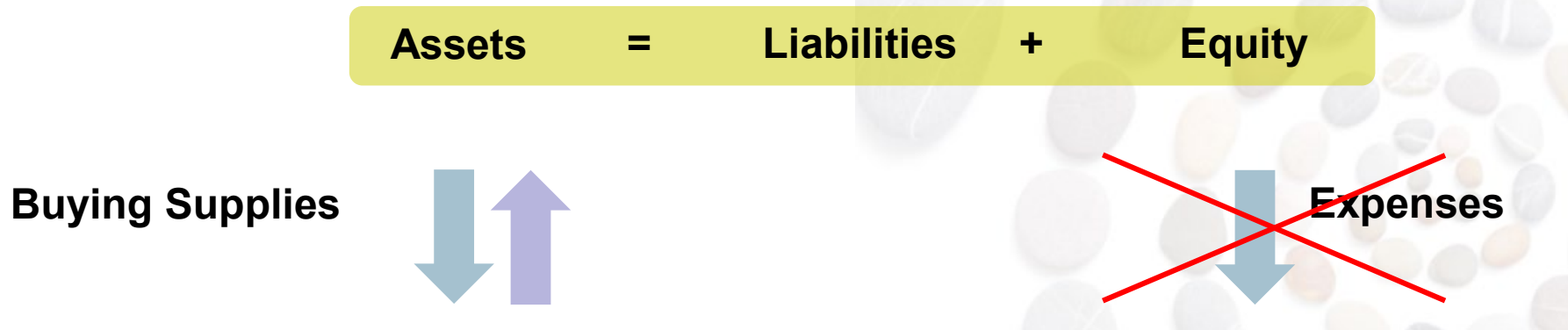
Components of a Statement of Comprehensive Income 綜合損益表

LO2

- NOT all inflows of assets are revenues.



- NOT all outflows of assets are expenses.



Components of a Statement of Comprehensive Income 綜合損益表

LO2

Other Comprehensive Income (OCI) 其他綜合損益

- Includes unrealized gains/losses due to the changes in value of some categories of securities, among others.
- OCI is an **equity**, not revenue or expense.
- **The balance will be carried forward.**

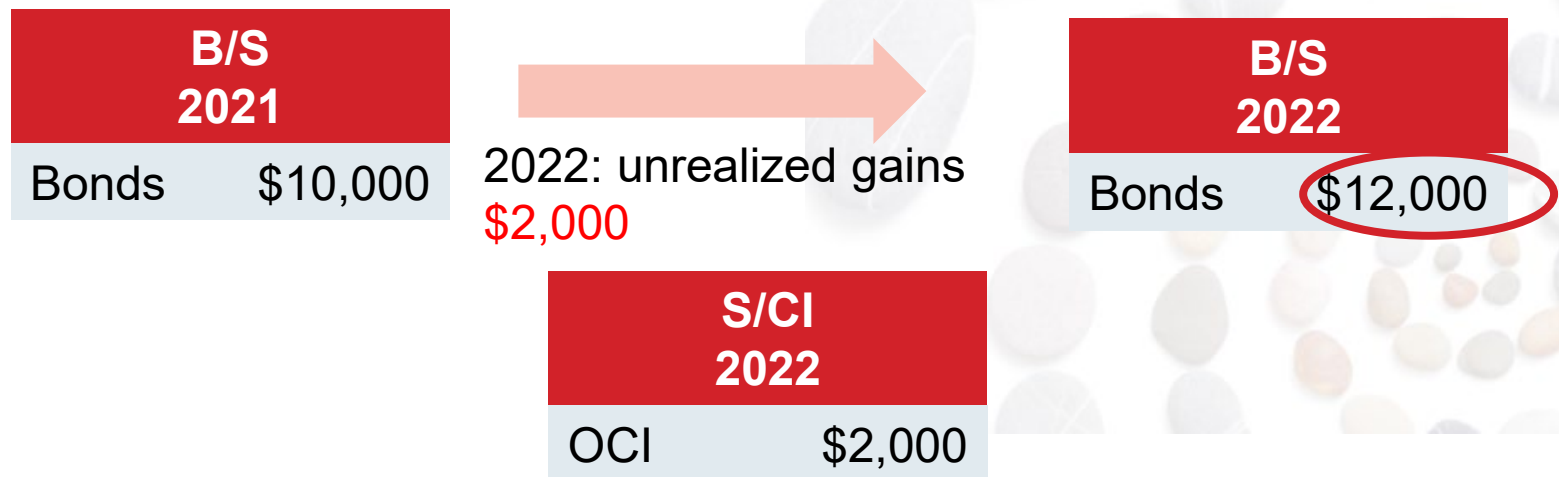


Components of a Statement of Comprehensive Income 綜合損益表

LO2

Other Comprehensive Income (OCI) 其他綜合損益

- On June 1, 2021, Springfield Inc. purchased bonds of Stillwater Company at the cost of \$10,000 as an investment to collect interest and to sell in the future.
- At the end of 2021, Springfield still held the bonds and market price increased to \$12,000.
- **The balance will be carried forward.**

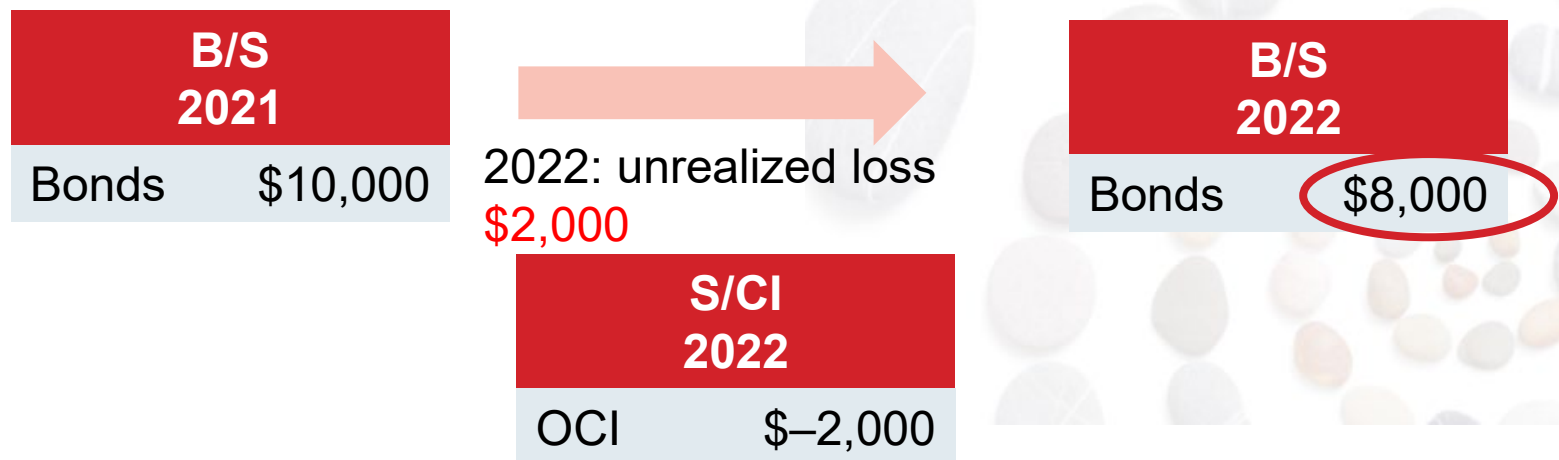


Components of a Statement of Comprehensive Income 綜合損益表

LO2

Other Comprehensive Income (OCI) 其他綜合損益

- On June 1, 2021, Springfield Inc. purchased bonds of Stillwater Company at the cost of **\$10,000** as an investment to collect interest and to sell in the future.
- At the end of 2021, Springfield still held the bonds and market price decreased to **\$8,000**.
- **The balance will be carried forward.**



Components of a Statement of Comprehensive Income 綜合損益表

LO2

Comprehensive Income 綜合損益

- A measure of the overall change in a company's wealth during a period.
- **Comprehensive income = Net income + OCI**
- The statement of comprehensive income
 - Covers a period of time
- The balance sheet
 - At a point in time

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

Revenues	\$ XXX
Expenses	<u>(XXX)</u>
Net income	XXX
Other Comprehensive income	<u>XXX</u>
Comprehensive income	<u>\$ XXX</u>

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

High Speed Company Statement of Comprehensive Income For the Years Ended December 31, 2022 and 2021 (Amounts in Thousands of New Taiwan Dollars)			a period of time
	2022	2021	Comparative financial statements
Service revenue	\$2,048	\$1,861	
Operating and administrative expense	(1,694)	(1,503)	
Operating profit	\$ 354	\$ 358	
Interest expense	(100)	(125)	
Non-operating income and expense	10	(5)	
Income before income tax	264	228	
Income tax expense	(7)	(15)	
Net income	\$ 257	\$ 213	
Other comprehensive income (loss) for the period	0	0	
Total comprehensive income for the period	<u>\$ 257</u>	<u>\$ 213</u>	
Earnings per share	\$1.22	\$1.01	

Exhibit 2.8

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

Operating and Non-Operating Categories

- Expense are divided into operating and non-operating
- **Non-operating revenues/expenses:** No connection with the specific nature of the operation of the business.
 - ▶ E.g., interest revenue, interest expense, tax expense, etc.

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

Gains or Losses 利益或損失

- Refer to money made or lost on activities outside the normal business of a company.
 - Philips sells consumer electronics. The amount is called **revenue**.
 - Philips makes money from **selling an old truck**. The amount is called a **gain**.
- Gains or losses are expressed in net amount, whereas revenues are in gross amount.

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

Earnings (Loss) per Share 每股盈餘

- The amount of net income (earnings) related to each share of stock.
- Earnings per share information tells the owner of a single share of stock how much of the net income for the year belongs to him or her.

$$\text{EPS} = \frac{\text{Net Income}}{\text{Outstanding Number of Shares of Stock}}$$

The Format of a Statement of Comprehensive Income 綜合損益表

LO2

Single Statement vs. Two Separate Statements

- IAS 1 also allows a company to present the comprehensive income in two separate statements: an income statement, and a statement of comprehensive income that starts with the amount of net income.

Philips' Statement of Comprehensive Income

Philips Group

Consolidated statements of comprehensive income in millions of EUR

For the year ended December 31

	2017	2018	2019
Net income for the period	1,870	1,097	1,173
²⁰ Pensions and other-post employment plans:			
Remeasurement	102	(8)	30
⁸ Income tax effect on remeasurements	(78)	(19)	3
Financial assets fair value through OCI:			
Net current-period change, before tax		(147)	82
Reclassification directly into retained earnings		(5)	
Total of items that will not be reclassified to Income Statement	25	(179)	114

Quiz Yourself

LO2

- **Review Philips' statement of comprehensive income in Appendix B and answer the following questions:**

1. What was Philips' net income for the fiscal year ended December 31, 2019?

Philips' net income for 2019 was €1,173 million.

2. How much were Philips' income tax expense for the fiscal year ended December 31, 2019?

Philips' income tax expense for 2019 was €337 million.

Quiz Yourself

LO2

3. What was Philips' other comprehensive income (loss) for the fiscal year ended December 31, 2019?

Philips' other comprehensive income for 2019 was €340 million.

4. What was Philips' total comprehensive income for the fiscal year ended December 31, 2019?

Philips' total comprehensive income for 2019 was €1,512 million.

The Statement of Changes in Equity 權益變動表

LO3

- Reports the changes in the elements of equity during a period of time.

High Speed Company Statement of Changes in Equity For the Years Ended December 31, 2022 and 2021 (Amounts in Thousands of New Taiwan Dollars)					
	Outstanding Number of Shares in Thousands	Capital Stock	Retained Earnings	Other Equity	Total Equity
Balance as of Dec. 31, 2020 ...	210	\$2,100	\$251	\$780	\$3,131
Net income			213		213
Other comprehensive income ...					—
Balance as of Dec. 31, 2021 ...	<u>210</u>	<u>\$2,100</u>	<u>\$464</u>	<u>\$780</u>	<u>\$3,344</u>
Net income			257		257
Other comprehensive income ...					—
Dividend distributed			(110)		(110)
Balance as of Dec. 31, 2022 ...	<u>210</u>	<u>\$2,100</u>	<u>\$611</u>	<u>\$780</u>	<u>\$3,491</u>

Exhibit 2.9

The Statement of Retained Earnings

保留盈餘表

LO3

- Shows the changes in retained earnings during a period of time.
- Ending R/E= Beginning R/E+ Net Income – Dividends**

High Speed Company
Statement of Retained Earnings
For the Year Ended December 31, 2022
(Amounts in Thousands of New Taiwan Dollars)

Balance, December 31, 2021	\$464
Net income for the year 2022	257
	<hr/>
	\$721
Cash dividends to shareholders	(110)
Balance, December 31, 2022	<u>\$611</u>

from statement of
comprehensive income

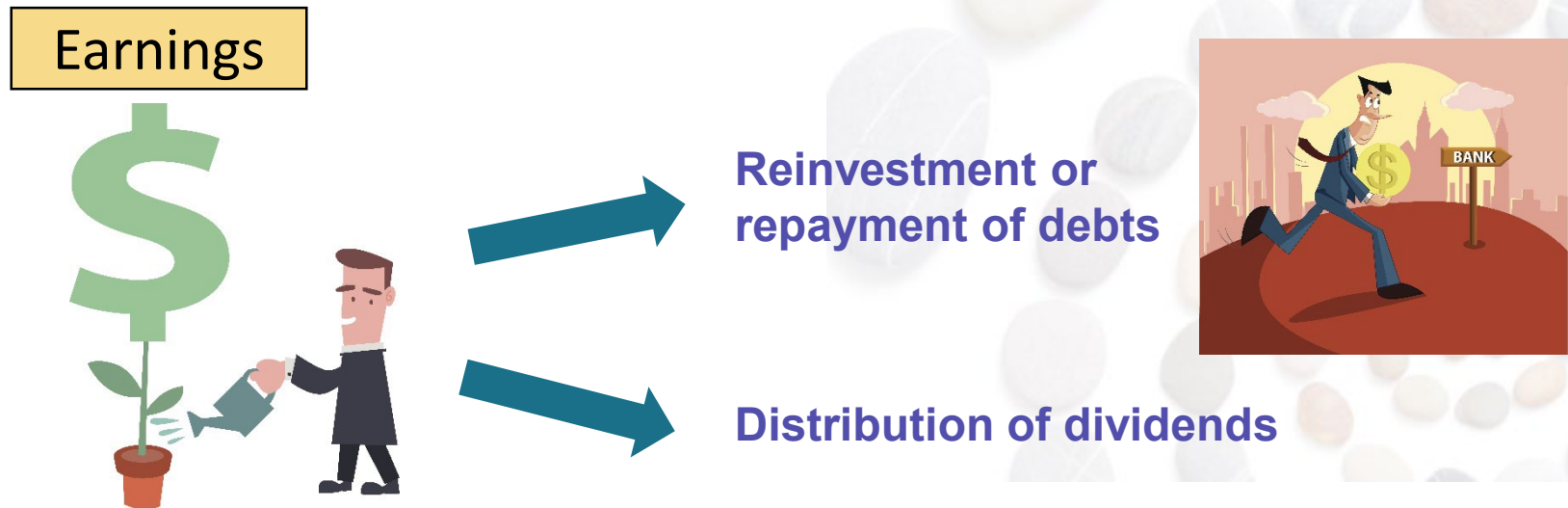
to balance sheet

Exhibit 2.10

What Is Retained Earnings?

LO3

- Retained earnings is the amount of a business's earnings that have been retained in the business, and is used to **reinvested back into the business or pay down debt.**
- The earnings that have not been retained in the business have been distributed to owners in the form of a **dividend.**



What Isn't Retained Earnings

LO3

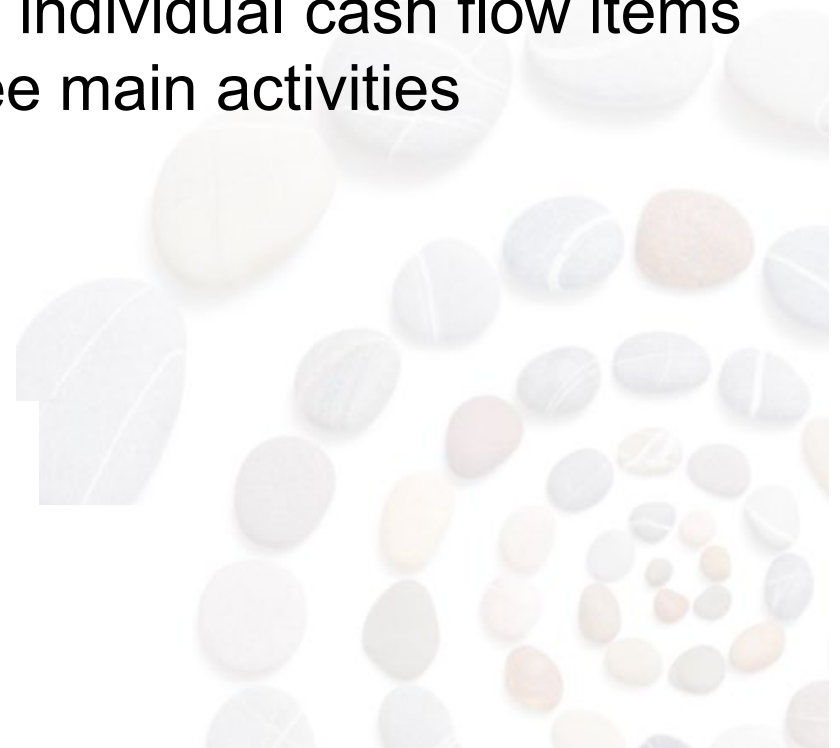
- Retained earnings is not cash.
- Sometimes it may be in the form of cash, but it is more likely that the cash has been used to purchase other assets or to pay off liabilities.



The Statement of Cash Flows 現金流量表

LO4

- Shows the cash inflows (receipts) and outflows (payments) of an entity during a period of time.
- In the statement of cash flows, individual cash flow items are classified according to three main activities
 - Operating activities
 - Investing activities
 - Financing activities



The Statement of Cash Flows 現金流量表

LO4

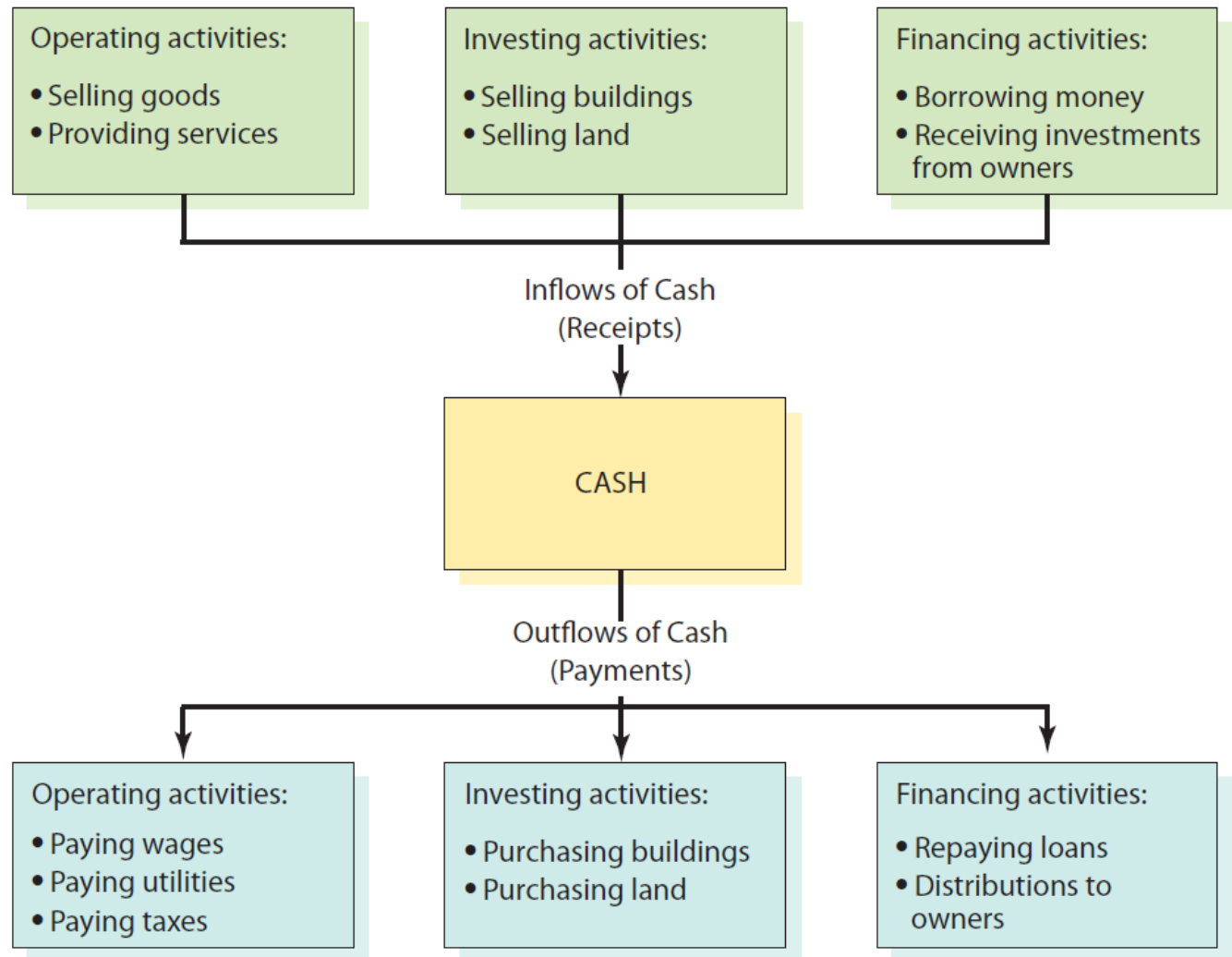


Exhibit 2.11
Cash Flows

The Statement of Cash Flows 現金流量表

LO4

High Speed Company Statement of Cash Flows For the Years Ended December 31, 2022 and 2021 (Amounts in Thousands of New Taiwan Dollars)		
Operating activities	2022	2021
Cash collected from customers	\$1,899	\$1,678
Cash paid for		
Purchasing supplies	(1,145)	(1,023)
Operating and administrative expenses	(388)	(402)
Tax	(7)	(15)
Net cash flows from operating activities	\$ 359	\$ 238
Investing activities		
Cash paid for property, plant, and equipment	\$ (350)	\$ (158)
Proceeds from disposal of property, plant, and equipment	557	111
Net cash generated by (used in) investing activities	\$ 207	\$ (47)
Financing activities		
Increase (Decrease) in short-term loans.	\$ (228)	\$ (152)
Dividends paid	(110)	—
Increase (Decrease) in long-term bank loans	(289)	50
Net cash generated by (used in) financing activities	\$ (627)	\$ (102)
Net Increase In Cash and Cash Equivalents	(61)	89
Cash and Cash Equivalents, Beginning of Period	2,472	2,383
Cash and Cash Equivalents, End of Period	<u>\$2,411</u>	<u>\$2,472</u>

Exhibit 2.12

How the Financial Statements Tie Together

LO4

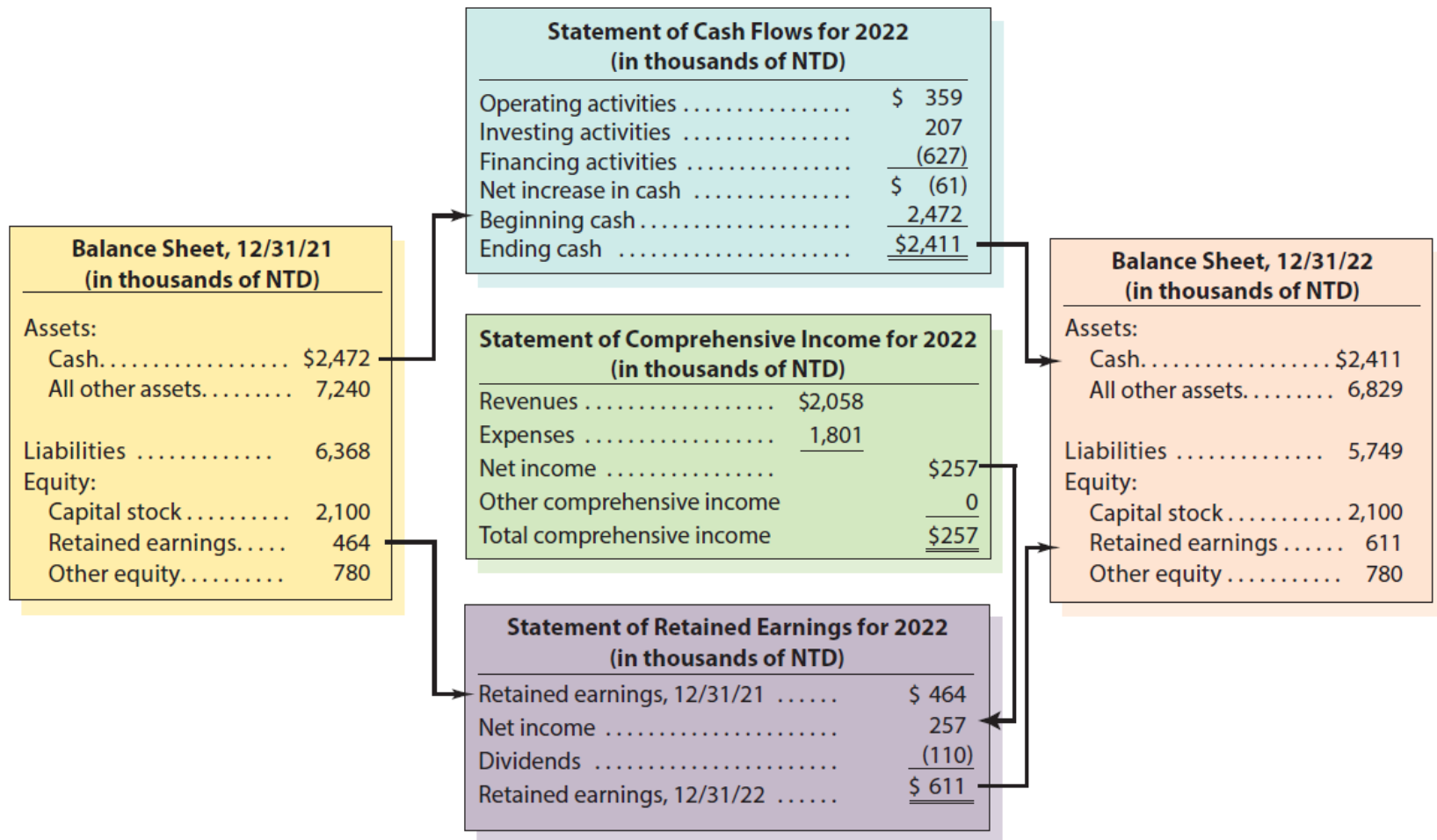


Exhibit 2.13

Notes 附註 to the Financial Statements

LO5

- Explanatory information considered an integral part of the financial statements.
- Financial statement notes fall into four general categories:

Summary of Significant Accounting Policies

Additional Information about the Summary Totals

Disclosure of Information Not Recognized

Supplementary Information (required by the IASB)

The External Audit 外部審計

LO6

- A company's financial statements are often audited by an independent certified public accountant (CPA).
- A CPA firm issues an **audit report** that expresses an opinion about whether the statements in accordance with generally accepted accounting principles.
- The financial statements are the responsibility of a company's management and not of the CPA.
- An audit report does not guarantee accuracy, but it does provide added assurance that the financial statements are not misleading.

The External Audit 外部審計

LO6

- Owners and managers want the most favorable results possible.
 - ✓ Gets loans
 - ✓ Bonuses
 - ✓ Public offerings (stock price)
- CPA firms have economic incentives to perform credible audits.
 - ✓ Reputation
 - ✓ Lawsuits

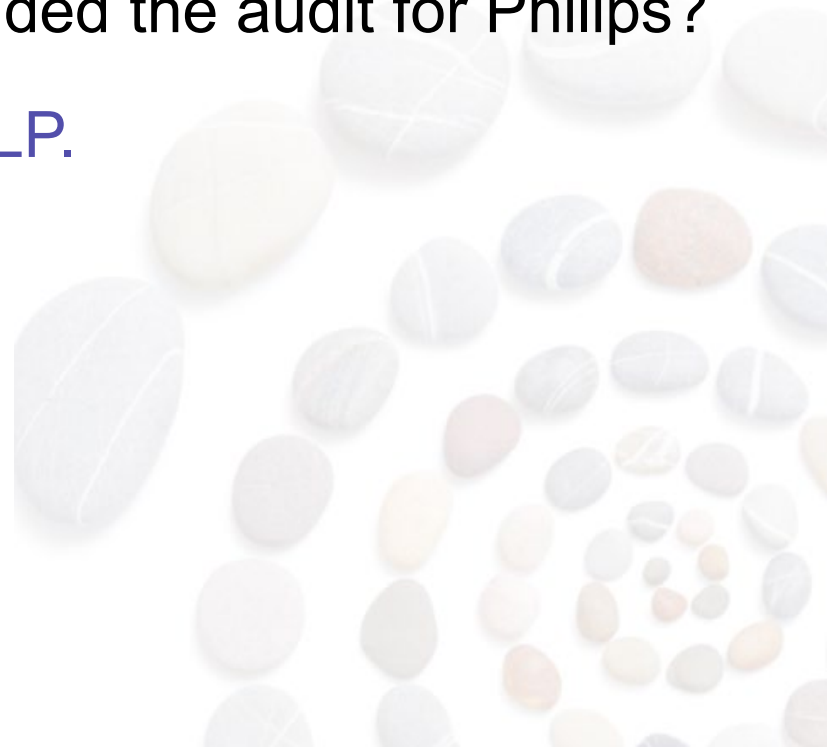
Quiz Yourself

LO6

- **Review Philips' audit report in Appendix B and answer the following questions:**

1. Which independent firm provided the audit for Philips?

Ernst & Young Accountants LLP.



Quiz Yourself

LO6

2. Philips has operations in more than 100 countries, over 115,000 employees, and sales of over €19 billion. How long did it take from the end of Philips' business year until the audit report was issued?

The date of Ernst & Young audit report was February 25, 2020. Philips' fiscal year ended on December 31, 2019. Ernst & Young was able to complete its audit in less than 60 days.

Fundamental Concepts and Assumptions

LO7

The Separate Entity Concept 企業個體假設

- An **entity** is defined as the organizational unit for which accounting records are maintained.
- In the **separate entity concept**, the activities of an entity are to be separated from those of the individual owners.

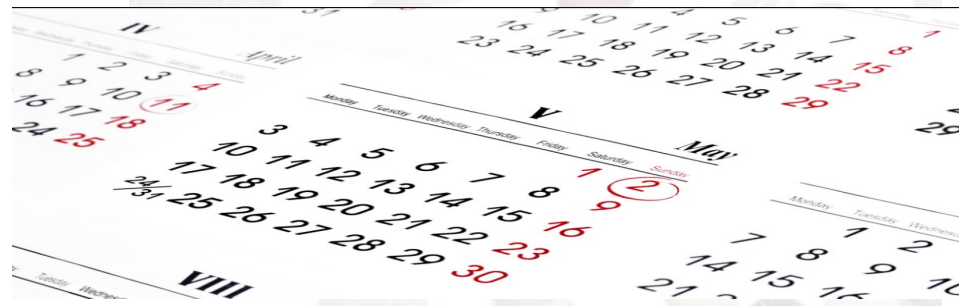


Fundamental Concepts and Assumptions

L07

The Time-Period Assumption 會計期間假設

- The idea used to report the results of activities over a standard time period, which is usually monthly, quarterly, or annually.
- With the time-period assumption, financial statements can be periodically prepared whereby investors, creditors, and other interested users can be informed of performance of the business.



The Assumption of Arm's-Length Transactions

一般/公平交易假設

- Business dealings between independent and rational parties who are looking out for their own interests.

The Cost Principle 成本原則

- The idea that transactions are recorded at their **historical costs** 歷史成本 or exchange prices at the transaction date.

Fundamental Concepts and Assumptions

L07

The Fair Value Principle 公允價值原則

- The idea that assets and liabilities be measured at **fair value** so that the relevance of accounting information can be improved.
- In some instances, IFRS allows companies to choose either historical cost or fair value approach (such as valuation of property, plant, and equipment).

Fundamental Concepts and Assumptions

L07

The Monetary Measurement Concept 貨幣(單位)衡量假設

The idea that

- Money is the accounting unit of measurement.
- Only economic activities measurable in monetary terms are included in the accounting model.



The Going Concern Assumption 繼續經營假設

- The idea that an accounting entity will have a continuing existence for the foreseeable future.
- Allows the accountant to record assets at what they are worth to a company in normal use, rather than what they would sell for in a liquidation sale.

